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C O N F I D E N T I A L SECTION 01 OF 03 PRETORIA 003560

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STATE PLEASE PASS TO USGS/GCOAKLEY

E.O. 12958: DECL: 08/04/2009
TAGS: EMIN EIND ETRD SF BC WA TZ AO CG GH CA
SUBJECT: SOUTH AFRICA: DEBEERS CONTEMPLATES THE U.S. MARKET AND "KIMBERLEY II"

Classified By: ECON M/C JHARTLEY, REASON: E.O. 12958 1.5 (d)

¶1. (C) Summary: On July 28, Econoff and EconFSN sat down to an hour-long conversation with Jonathan Oppenheimer, Director of E. Oppenheimer and Sons and Managing Director of De Beers Consolidated Mines, Ltd., to review the landscape for De Beers in the wake of its July 13 settlement with the U.S. Department of Justice on a 1994 price fixing charge. In line with the company's commitment "to be legally compliant throughout the world," De Beers pled guilty to having fixed industrial diamond prices and agreed to pay a fine of USD 10 million. The settlement means that De Beers executives can freely travel to the United States and expand the company's business in the world's most lucrative consumer market. Oppenheimer talked about how De Beers had already started to leverage its well-known name in international retail markets. However, the pace of entry into the United States retail market would be determined by the company's ability to "extinguish its liabilities" stemming from U.S. civil law suits (now three in number). Oppenheimer lobbied for U.S. support of a scheme using "smart cards" to register the activities of small-scale diamond miners and traders in Africa under what he termed "Kimberley Process II." End Summary.

Next in Line

¶2. (SBU) At 34 years old, Jonathan Oppenheimer is the youngest heir to Ernest Oppenheimer's original fortune made from the mining and sale of South African rough diamonds and gold. Over the past several years, Jonathan Oppenheimer has assumed a higher political profile in De Beers, particularly with respect to South African mining legislation and company operations in Africa. As Managing Director of Consolidated Mines, Ltd., he is responsible for South African operations. As a Director of E. Oppenheimer and Sons, he is also responsible for African producer relations. Jonathan's father, Nikki, succeeded Jonathan's grandfather, Harry, as Chairman of De Beers in 1998. Jonathan now works along side Nikki in the Johannesburg offices of E. Oppenheimer and Sons. The Oppenhiemer family owns 45 percent of De Beers outright, and controls another 5 percent or so through direct and indirect shareholdings in Anglo American (which owns 45 percent of De Beers) and Debswana, a 50/50 joint venture between De Beers and the Government of Botswana. Though young, Jonathan Oppenheimer occupies a privileged position from which to represent De Beers' interests.

De Beers Still the Dominant Force

¶3. (SBU) Despite growing competition, De Beers is still the dominant force in diamond mining and marketing in the world today. In 2003, the De Beers Group mined 43.9 million carats, or about 31 percent of world production, mostly from Botswana (30 million carats) and South Africa (11.9 million carats), but also from Namibia (1.5 million carats) and Tanzania. In a race with a growing number of diamond mining companies, De Beers is actively exploring in Canada, Russia, Brazil, India, and participating in early stage joint ventures in Australia and several other African countries.

¶4. (C) De Beers' Diamond Trading Company (DTC), successor to the Central Selling Organization (CSO), still controls about two-thirds of the rough diamond market. Most supply is guaranteed by De Beers Group mines (41 percent by value). The rest comes from direct purchases, especially from Alrosa, Russia's diamond mining company. In 2003, the DTC logged a record USD 5.5 billion in sales, partly because of higher diamond prices and the decision to sell off excess inventory. In addition, the DTC has embarked on a marketing strategy to generate consumer demand for diamonds, which De Beers feels lags behind other luxury goods. Increased demand, lower DTC inventory levels, fewer purchases from Alrosa, and equipment failures reducing production at De Beers Group mines in Botswana lead some analysts to believe that the industry may be heading toward a supply crunch and higher prices in the near future. Oppenheimer said that De Beers was concerned that the level prices stay relatively stable to encourage consumer demand, and to discourage accusations that once again De Beers may be manipulating the market.

Kimberley Process II

¶5. (C) Oppenheimer took the opportunity of this meeting with U.S. officials to lobby for De Beers' idea of using smart cards and reading devices to register small-scale miners and traders in Africa who currently fall outside the Kimberley Process Certification Scheme. Oppenheimer believes that the system could connect miners to national ministries, help track regional diamond trade, and even provide a vehicle for payment. He estimated that some USD 700 million in small-scale diamond production were falling outside the Kimberley Process, but believed that most of this was the result of legitimate small scale mining. Oppenheimer thought that smart cards could form the basis of a "Kimberley II." Kimberley certification would mean that De Beers could enter these local rough diamond markets and pay up to six times more than local traders were paying the small-scale miners now. De Beers wanted to garner U.S. and other Kimberley Process country support to push this idea toward a U.N. Security Council resolution.

¶6. (C) Ever wary of competition and the possibility of unsavory characters tarnishing the diamond trade, Jonathan Oppenheimer took the opportunity of the meeting to raise ethical questions about the Lev Leviev Group, De Beers' Namibian competitor. He went out of his way to say that De Beers was concerned about Leviev's shady past as an Israeli arms dealer, but admitted that De Beers had no hard evidence of his trade in conflict diamonds or use of diamonds as a means to launder money.

Marketing

¶7. (C) Oppenheimer spoke about the shift in De Beers' strategy from one that controlled the supply (and price) of diamonds to one that focused on demand. Under its "Supplier of Choice" initiative, De Beers was joining with leading diamantaires (DTC sightholders) to stimulate consumer demand. Research showed that consumer demand for diamond jewelry consistently trailed other luxury goods. De Beers wanted to change this by advertising more and branding diamonds to tap into the different segments of the retail market. Central to this approach was "leveraging" the De Beers name with consumers and accessing the U.S. market, which accounted for 50 percent of the world's retail market for diamonds.

¶8. (C) Oppenheimer said that market research had revealed that consumers viewed the name "De Beers" as being synonymous with quality diamonds, even though De Beers did not even participate in the retail market. To capitalize on this phenomenon, De Beers had decided to leap frog the cutting and polishing industry and move directly into retail, where the markups were especially high. In fact, De Beers had already joined with experienced retailer Louis Vuitton Moet Hennessy (LVMH) to open high end diamond jewelry stores in London and Tokyo. Under an agreement with the EU's Competition Commission, De Beers promised to not source diamonds solely from itself to supply its retail outlets. Oppenheimer thought that about 20 percent would likely come from non-DTC sources. Oppenheimer confirmed that De Beers/LVMH planned to open a store in New York City, but said that De Beers was in "no rush" to enter the U.S. market. Referring to three civil law suits pending U.S. courts (involving potential commercial damages from past CSO selling practices), Oppenheimer said that De Beers intended to "extinguish its liabilities" before moving rapidly into the U.S. retail market.

South Africa Mining Legislation

¶9. (C) Oppenheimer decried recent confusion in South Africa over Black Economic Empowerment (BEE) ownership requirements for mining and exploration licenses on state owned land. Despite the government's clarification that its 51 percent BEE ownership requirement would be limited in duration, it was entirely unclear to him as to how the requirement would revert after one year to the 26 percent set forth in the mining industry's BEE charter. He further commented that applying BEE ownership requirements to exploration was especially problematic, since there were no black owned companies operating in this area and few black investors with deep pockets to fund exploration. Oppenheimer also decried the deleterious effect that the debate over mining royalty levels was having on the South African investment climate for mining. No matter the level, he thought that the government would be advised to resolve the issue soon, as the uncertainty was freezing many investment decisions.
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